

# Australian trade deficit soars to new record

## Treasurer warns of "tight budget"

Mike Head  
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Australia's trade deficit hit its second successive monthly record in February, pointing to a looming balance of payments crisis produced by declining world commodity prices and the collapse of key Asian export markets. Money markets reacted badly to the news, with the Australian dollar falling half a US cent to a three-week low soon after Tuesday's announcement.

The \$A1.52 billion deficit surprised financial analysts, far exceeding their forecast of around \$950 million. It was a considerable jump from the previous record of \$1.38 billion, set just a month earlier. Moreover, it confirms a pattern of worsening deficits as the Asian financial meltdown continues.

On the trend graph produced by the Bureau of Statistics, the deficit line plunges relentlessly from around \$200 million a month in 1997, when the Asian breakdown began, and seems headed towards \$2 billion a month by the end of 1999.

The trade deficit has totalled \$3.7 billion over the past three months. If this is added to the near-\$5 billion deficit on dividends and interest payments--primarily due to repayments on the mounting foreign debt--the resulting balance of payments deficit is close to 6 percent of Gross Domestic Product, a level that financiers regard as dangerous. The economy is headed for a \$35 billion balance of payments deficit in 1999, raising the spectre of a run on the currency.

Even more disturbing for the government and the financial markets is the composition of the trade deficit. Exports languished, rising only 0.9 percent, while imports increased by 2 percent. Total exports came to \$9.1 billion, almost 10 percent below their August 1988 peak.

Most notably, merchandise exports to major Southeast Asian and North Asian markets fell 8 percent in February. Exports to the largest market, Japan,

dropped 8 percent, while exports to South Korea were down 24 percent. This is also part of a longer-term trend, with exports to the same group of countries falling 8 percent in the eight months to February 1999, compared to the eight months to February 1998. Exports to all other countries rose 14 percent over the same period, although higher gold exports accounted for more than half this rise.

On the import side, there was an 8.6 percent surge in consumer imports, but a 4.2 percent drop in capital goods, which are needed to sustain production. In particular, imports of machinery and industrial equipment were down 21 percent.

Several financial commentators expressed mounting concern over the figures, even as they tried to prevent an adverse international response.

Bankers Trust Australia's chief economist, Dr Chris Caton, said the growing deficit needed close watching, but panic should be avoided. "In a world where there is extraordinary financial market volatility, you run the risk of someone saying, 'hey, what about Australia?' You don't want to attract the attention of speculators."

Caton acknowledged that the current annual rate of economic growth in Australia--around 3.75 percent--could not last. "At the moment, you have a scenario where Australia is growing at the world rate plus 2 percent, and that's not sustainable."

Su-Lin Ong, senior economist at RBC DS Global Markets, said the trade figures could renew downward pressure on the Australian dollar. "It was a record monthly trade deficit and suggests the first quarter current account deficit will be a big one. The data puts us on track for a [first quarter] record, deteriorating towards 5.75 percent of GDP."

Grant Fitzner of HSBC Markets played down the prospect of a dramatic run on the Australian currency,

as happened in 1986-87, but said the figures would increase the focus on the poor current account. "When you get one bad trade number, people just shrug it off as volatility, but when you get two consecutive numbers like this, then obviously it is some cause for concern."

The unease was heightened by further falls in global commodity prices, which are at a 24-year low. The Bridge-Commodity Research Bureau index dropped from 192.7 to 192.4 on Tuesday, mainly due to tumbling copper prices. Australian business depends heavily on exports of raw materials such as grains, wool, meat, coal and minerals.

Federal Treasurer Peter Costello sought to calm the nervous markets but his message was contradictory. On the one hand, he said the trade figures were in line with the government's forecasts and were the outcome of "robust" domestic growth in the face of severe recessions in Asian countries. On the other hand, he said there was no room for complacency.

"What this means is we are going to have a tight Budget and we are going to have to make sure that we keep the Australian Commonwealth Government in surplus," he said. This indicates deeper cuts to social spending, on top of draconian cutbacks over the past 15 years in fields such as tertiary education, child care, legal aid, immigration, welfare benefits and public health and housing.

The actual content of Costello's "robust" growth was also underlined by a government survey of business expectations. It showed that in the year ahead, companies expected profits to rise by 16.2 percent but employment to fall by 0.2 percent. The generation of profits via job destruction has been an ever more clear tendency over the past two years.

On the surface, the Australian economy appeared to grow strongly throughout 1998, despite the Asian turmoil. Yet while profits soared, and share prices rose, these gains were at the cost of full-time jobs. Now the underlying impact of the Asian reversal, plus the decline in productive investment, is beginning to make itself felt.



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